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No. 06-94

Supreme Court, U.S.
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In The

Supreme Court of the United States

FULLER-AUSTIN INSULATION COMPANY, f/b/o FULLER-AUSTIN ASBESTOS SETTLEMENT TRUST,

Petitioner,

v.

HIGHLANDS INSURANCE COMPANY, *et al.*,

Respondents.

On Petition For A Writ of Certiorari To The California Court Of Appeal, Second Appellate District, Division Two

BRIEF OF *AMICI CURIAE* THE BABCOCK & WILCOX COMPANY ASBESTOS PI TRUST, THE CELOTEX ASBESTOS SETTLEMENT TRUST, THE PLIBRICO 524(g) ASBESTOS TRUST, THE WESTERN ASBESTOS SETTLEMENT TRUST, AND THE COMBUSTION ENGINEERING 524(g) ASBESTOS PI TRUST IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST

The Babcock & Wilcox Company Asbestos PI Trust, The Celotex Asbestos Settlement Trust, the Plibrico 524(g) Asbestos Trust, the Western Asbestos Settlement Trust, and the Combustion Engineering 524(g) Asbestos PI Trust (collectively, "*Amici*") were established under the United States Bankruptcy Code for the benefit of those injured by asbestos-containing materials made, sold, or installed by the bankrupt predecessors of *Amici*. As discussed more fully below, *Amici* were born of the same necessities as Petitioner's trust, namely, to discharge debilitating asbestos liabilities while ensuring fair compensation to all injured claimants. Thus, *Amici* have a strong interest in the outcome of the petition for certiorari filed by Petitioner Fuller-Austin Insulation Company ("Fuller-Austin").[1]

BACKGROUND

The Asbestos Problem

Many attempts have been made over the past twenty-five years to resolve what this Court has called the "elephantine mass" of asbestos cases clogging the tort system today. *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 821 (1999). Millions of tort claims have been filed, alleging

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[1] As required by Rule 37.6 of this Court, counsel for *Amici* state that they authored this brief in its entirety and that no party or parties other than *Amici* made any monetary contribution to the preparation or submission of this brief. As required by Rule 37.2, consent to the filing of this brief has been obtained from all parties. The consents of the following parties were obtained by email: Stonewall Insurance Company, Certain Underwriters at Lloyd's London and Certain London Market Insurance Companies, Brittany Insurance Company, Compagnie Europeene, and International Insurance Company. Copies of these e-mails are being filed with this brief. The consent of the remaining parties was obtained orally. Counsel for *Amici* will file a letter memorializing written consent from the remaining parties.

billions of dollars of personal injury and/or property damage from exposure to asbestos-containing materials.[2] The overwhelming burden of such claims, in terms of both litigation costs and tort liabilities, has so far driven more than seventy companies into bankruptcy, including *Amici's* predecessors and Fuller-Austin.[3]

Crafting a long-term solution to the asbestos crisis is challenging not merely because of the sheer number of claimants and defendants, but because of the long latency period for asbestos injuries, which frequently do not manifest themselves until decades after exposure. *See Amchem Prods. v. Windsor*, 521 U.S. 591, 598 (1997). To pass muster, any resolution of asbestos liabilities must address both present and future claimants (those who have not yet manifested a disease and filed a claim). *See id.* at 610-11, 626-28 (rejecting global settlement of asbestos claims on grounds that it failed to protect rights of claimants who had not yet manifested a disease). In light of the decisions in *Amchem* and *Ortiz*, which likewise rejected a class settlement of asbestos claims for failing to respect the rights of future claimants, the bankruptcy process is now the only allowable way for companies to discharge future asbestos liabilities. Indeed, Congress enacted section 524(g) of the

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[2] For example, shortly before The Babcock & Wilcox Company filed for bankruptcy protection, the number of asbestos-related claims filed against it was over 400,000. *In re Babcock & Wilcox Co.*, No. 00-10992, at 5, 37 (Bankr. E.D. La. Dec. 28, 2005), *available at* http://www.laeb.uscourts.gov/Opinions/pdf/00-10992-7027.pdf. During the Celotex Corporation's bankruptcy, approximately 737,000 asbestos-related bodily injury proofs of claim were filed against the company, alleging more than $200 billion in damages. *In re Celotex Corp.*, 204 B.R. 586, 604 (Bankr. M.D. Fla. 1996).

[3] *See* RAND Institute for Civil Justice, *Asbestos Litigation*, at 109 (2005), *available at* http://www.rand.org/pubs/monographs/ 2005/ RAND_MG162.pdf.

Bankruptcy Code, 11 U.S.C. § 524(g), to lay out the blueprint for accomplishing this goal, and insurance proceeds are an important part of that plan.

Section 524(g)

Amici were created pursuant to bankruptcy reorganization plans under section 524(g), the same provision upon which Fuller-Austin relied as authority for its reorganization plan. As required by section 524(g), these plans provide for the resolution of asbestos-related claims against the debtors and the establishment of *Amici* as the vehicles to pay these claims for the exclusive benefit of asbestos claimants. *See, e.g., In re Celotex Corp.*, 204 B.R. at 602, 604. To this end, the plans transfer various of the debtors' assets to *Amici*, including, among other things, the rights to the proceeds of the debtors' insurance policies. *See, e.g., id.* at 602-03. These policies typically require the insurers to provide sweeping coverage for "all sums" that the policyholders became obligated to pay as a result of, *inter alia*, asbestos personal injuries. In exchange for these assets, *Amici's* predecessors are fully discharged from their asbestos-related liabilities, which are transferred to *Amici*. *See, e.g., id.* at 609-10. *Amici* then pay claimants pursuant to criteria approved by the courts. *See, e.g., id.* at 610, 613.

The non-insurance assets transferred to *Amici* cannot, by themselves, satisfy the billions of dollars in present and future asbestos-related liabilities.[4] Accordingly, section

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[4] Indeed, several companies with asbestos liabilities have cited the importance of their insurance in opposing proposed federal legislation that would require relinquishment of insurance coverage to a federally run fund, along with cash payments, to resolve outstanding asbestos liabilities. *See S. 852: A Fair and Efficient System to Resolve Claims of Victims for Bodily Injury Caused by Asbestos Exposure, and for Other Purposes, Hearings Before the S. Committee on the Judiciary,* 109th Cong. 47-48 (Apr. 26, 2005) (statement of Carol Morgan), *available*

(Continued ...)

524(g) provides that trusts like *Amici* pay, in the first instance, only a percentage of the full liabilities established by each claimant (the "initial payment percentage").[5] Paying each claimant less than the full amount of his claim ensures that there will be adequate assets available for distribution to future claimants. If and when additional assets become available, *e.g.*, if the *Amici* recover insurance proceeds from previously recalcitrant insurers or the claims are fewer than expected, the *Amici* increase the amount paid to claimants (and pay additional amounts to those claimants who already were paid).

SUMMARY OF ARGUMENT

According to the Court of Appeal, once a bankrupt policyholder has received a discharge pursuant to a plan of reorganization, an insurer's obligation is limited to the initial payment percentage, *i.e.*, the amount that trust can initially afford to pay from the assets it has received from the bankrupt policyholder. *Fuller-Austin Insulation Co.*, 38 Cal. Rptr. 3d at 747, 749. This limitation produces perverse results.

Under section 524(e) of the Bankruptcy Code, 11 U.S.C. § 524(e), the discharge of a debtor from its debt does not relieve the obligation of any other entity (*e.g.*, an insurer) that may be liable for the debt. The insurers' policies

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at http://frwebgate.access.gpo.gov/cgi-bin/useftp.cgi?IPaddress=162.140.64.128&filename=26841.wais&directory=/diskb/wais/data/109_senate_hearings.

[5] The Court of Appeal referred to the full amount of the liability as the "Allowed Liquidated Value," or "ALV," and to the amount actually paid by the Fuller-Austin Trust as the "payment sum percentage." *See, e.g.*, *Fuller-Austin Insulation Co. v. Highlands Ins. Co.*, 38 Cal. Rptr. 3d 716, 724 (Cal. Ct. App. 2006).

similarly provide that the bankruptcy of the policyholder shall not relieve the insurers of their policy obligations.

Section 524(e) plainly prohibits an insurer from reducing its liabilities merely on the basis of its policyholder's bankruptcy and subsequent discharge. Under the Court of Appeal's decision, however, the liability of insurers for the debts of their policyholders turns not on what federal law requires in section 524(e) or on what the insurers promised in their policies, but rather on the amount of non-insurance assets transferred by the policyholder to the trust under the plan of reorganization. Thus, if a bankrupt policyholder had no assets other than insurance to transfer to a trust, and the insurers denied coverage, the trust initially would have no assets with which to pay claims and would have to set the initial payment percentage at zero. Under the Court of Appeal's decision, the insurers could then argue that, because the trust's payment percentage was zero, they would have no obligation to pay anything under their policies. Even if the Trust had non-insurance assets and, for example, could set the payment percentage at 10%, the insurers could still argue under the Court of Appeal's ruling that their obligation was not for the amount of the debt to the injured claimant, but rather for the reduced amount the trust could afford to pay the claimant.

By allowing insurers to limit their liabilities based on the happenstance of their policyholder's bankruptcy and subsequent discharge, the Court of Appeal has disregarded not only Congress's express direction in section 524(e), but also well-established federal case law. *See UNR Indus., Inc. v. Cont'l Cas. Co.*, 942 F.2d 1101, 1105 (7th Cir. 1991) (holding that insurer must pay the amount of the bankrupt policyholder's debt, and not merely what the successor trust can afford to pay).

Thus, the Court of Appeal's decision threatens to strip from existing trusts much of the value of the insurance rights they received from their debtor-predecessors, substantially reducing the amounts available for their beneficiaries, while the insurers obtain a windfall. *See id.*; *West v. White (In re White)*, 73 B.R. 983, 985 (Bankr. D.D.C. 1987). Moreover, the Court of Appeal's decision actually creates an incentive for insurers to deny coverage, force their policyholders into bankruptcy and then argue that their liability should be reduced to whatever the trust can afford to pay. This surely was not Congress's intent in crafting section 524 as a tool for reorganization.

For these reasons, and in view of the fact that this Court has not yet addressed these important federal questions, certiorari should be granted.

ARGUMENT

A. Certiorari Should Be Granted Because the Decision Below Directly Contravenes Section 524(e) of the United States Bankruptcy Code

Section 524(e) of the Bankruptcy Code provides that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). This provision embodies the long-standing principle of "providing the debtor with a 'fresh start' but avoiding the grant of a windfall to third parties." *In re Bd. of Dirs. of Hopewell Int'l Ins., Ltd.*, 281 B.R. 200, 210 (Bankr. S.D.N.Y. 2002); *see also Lewis v. Mfrs. Nat'l Bank of Detroit*, 364 U.S. 603, 608-09 (1961) (rejecting a construction that "would enrich unsecured creditors at the expense of secured creditors, creating a

windfall merely by reason of the happenstance of bankruptcy").[6]

The decision below, which did not consider section 524(e), would do precisely what section 524(e) is designed to avoid: allow insurers to take advantage of their policyholder's bankruptcy and subsequent discharge to reduce or eliminate their liability for the policyholder's debt.

According to the Court of Appeal, in the event of a policyholder's insolvency, an insurer would be relieved of all of its payment obligations that exceed the ability of the policyholder or a successor trust to pay. As a result, if a trust has no assets other than rights under disputed insurance policies, and therefore initially cannot pay any amount to any claimant, the insurer also would pay nothing under its insurance policy – notwithstanding the fact that, outside of the bankruptcy context, the insurer would have to pay millions of dollars. This outcome is prohibited by section 524(e). *In re Jet Fla. Sys.*, 883 F.2d at 975 (holding that the "fresh start" offered by the Bankruptcy Code "is not intended

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[6] The earlier version of this provision, section 16 of the Bankruptcy Reform Act of 1898 (11 U.S.C. § 34, repealed Oct. 1, 1979), preserved the liability of a party that "is a co-debtor with, or guarantor or in any manner a surety for" the debtor. Section 524(e) removed any such limitation, affirming "the liability of *any other entity* on" the debt of the debtor (emphasis added). Even under the more restrictive language of section 16, courts have maintained that the discharge of a debtor's debts "does not operate to release claims against parties liable with the bankrupt, whether liquidated, as in the case of debts, or unliquidated, as in the case of claims based on torts." *Johnson v. Bondurant*, 359 P.2d 861, 865 (Kan. 1961). *See also In re Bracy*, 449 F. Supp. 70, 71 (D. Mont. 1978) (deciding that "if an insurance company is as a matter of state law liable to a plaintiff in a personal injury action, subsequent discharge of the assured in bankruptcy does not alter the obligation of the insurance company."); *In re Jet Fla. Sys., Inc.*, 883 F.2d 970, 975 (11th Cir. 1989) (citing cases holding same under section 16).

to provide a method by which an insurer can escape its obligations based simply on the financial misfortunes of the insured."); *see also Green v. Welsh*, 956 F.2d 30, 33 (2d Cir. 1992) (language of section 524 reveals that Congress sought to free the debtor of his personal obligations while ensuring that no one else reaps a similar benefit; thus, relief given to debtor by section 524 does not extend to other parties).

In deciding *Jet Florida*, the Eleventh Circuit repeatedly invoked section 524(e) as the basis for an insurer's obligation to answer for liabilities that a bankrupt policyholder itself could not pay. 883 F.2d at 973-76. The debtor's inability to pay either the cost of defending the tort action or the tort liability itself did not alter in any way the insurer's obligations under the insurance contract. Under the Court of Appeal's ruling, by contrast, the bankruptcy and subsequent discharge of the policyholder would magically (and improperly) transform the insurer's obligation to cover liabilities owed by the policyholder into an obligation to cover only those liabilities that the policyholder or its successor trust can afford to cover on its own. Indeed, the Court of Appeal's ruling actually creates an incentive for insurers to deny coverage for liabilities arising from mass torts, drive their policyholder into bankruptcy, and then rely on the decision below to reduce their coverage obligations to the amount the policyholder's successor trust can afford to pay.

Ignoring this perverse incentive, the court below asserted that holding insurers responsible for liabilities greater than what the debtor-policyholder could cover on its own somehow would unfairly award the policyholder a windfall. *Fuller-Austin Insulation Co.*, 38 Cal. Rptr. 3d at 746. Nothing could be further from the truth. As the Petition notes, Fuller-Austin's claimants are initially paid only a percentage of the value of their allowed claims in order to comply with section 524(g)'s requirement that assets

be set aside to compensate future asbestos claimants. Pet. at 9. Thus, additional amounts paid into the trust by the insurers do not provide the trust with a windfall. Rather, such payments make it possible for the trust to increase payments to the claimant beneficiaries of the trust.[7] The same is true for *Amici*.

Moreover, to have insurers cover losses and liabilities that policyholders cannot afford to pay is the *raison d'être* of insurance contracts. *See, e.g., Harbor Ins. Co. v. Cont'l Bank Corp.*, 922 F.2d 357, 368 (7th Cir. 1990) (the point of insurance policies is to eliminate solvency risk). Section 524(e) merely codifies this goal in the bankruptcy context. For Respondents to insist that their obligations are reduced because Fuller-Austin has been discharged from its tort liabilities and the successor trust cannot fully satisfy them misconstrues the objectives of bankruptcy law. As the Eleventh Circuit stated in *Jet Florida*, "[t]he reported cases ... underscore that the purpose of section 524 of the Bankruptcy Code is to protect the debtor and not to shield third parties such as insurers who may be liable on behalf of the debtor." 883 F.2d at 975.[8]

Thus, under section 524(e), insurers remain fully liable on their policies notwithstanding the bankruptcy of their policyholder and the subsequent discharge of its debts to tort claimants.

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[7] Even if all insurance assets are recovered and distributed, it is highly unlikely that claimants of Petitioner and *Amici* ever will be compensated in full.

[8] Indeed, the court in *Jet Florida* went so far as to hold that, notwithstanding a debtor's discharge in bankruptcy, a third party could sue the debtor to establish its liability, in order to collect the debt from the insurer. *Jet Florida*, 883 F.2d at 976.

> Any other outcome would result in a windfall to insurers, which receive premiums as the *quid pro quo* for providing insurance. Any other outcome would also disadvantage both innocent, third-party, personal-injury claimants and innocent general creditors of any bankruptcy estate in which there are assets available for distribution to creditors, whose pro rata share of those assets must necessarily diminish by inclusion of a claim that could be but is not paid by insurance.

In re White, 73 B.R. at 985. Numerous courts have reached the same conclusion. *See, e.g.*, *Green v. Welsh*, 956 F.2d at 32; *In re Catania*, 94 B.R. 250, 251 (Bankr. D. Mass. 1989); *In re Mann*, 58 B.R. 953, 956 (Bankr. W.D. Va. 1986); *In re McGraw*, 18 B.R. 140, 143 (Bankr. W.D. Wis. 1982); *In re Honosky*, 6 B.R. 667, 670 (Bankr. S.D. W. Va. 1980).

Given the well-settled rulings by state and federal courts alike reached under section 524(e) and its predecessor, the Court of Appeal's ruling cannot stand. Allowing Respondent-Insurers to reduce their obligations based on the debtor's bankruptcy and subsequent discharge is anathema to the letter and spirit of the Bankruptcy Code and requires this Court's intervention.

The Court of Appeal's decision likewise conflicts with the Seventh Circuit's decision in *UNR Industries*. There, the insurer made the same argument that Respondents make here – that the extent of its obligations "depends on how much money the Trust actually pays to asbestos victims with valid claims." 942 F.2d at 1105. Unlike the Court of Appeal, the Seventh Circuit rejected this argument, reasoning that it

> threatens to confer a windfall on [the insurer] at the asbestos victim's expense. The reason for the potential windfall is that UNR paid the Trust only a portion of the asbestos victims' actual damages in the bankruptcy proceedings. This discounting of the asbestos victims' damages had nothing to do with the merits of their claims. The discounting merely reflected the amount of UNR's assets that the asbestos victims could reach. [The insurer] may profit greatly from UNR's bankruptcy if its obligations are based on the arbitrarily discounted amount that the asbestos victims actually receive from the Trust.

Id. This conflict between the Court of Appeal's decision and *UNR Industries* warrants the granting of the Petition.

B. This Court Should Grant Review Because the Court of Appeal's Decision Would Eviscerate Section 524(g) of the Bankruptcy Code

As Petitioner's brief ably asserts, the Court of Appeal's decision impermissibly frustrates the purpose of section 524(g), Congress's carefully crafted mechanism for handling asbestos-related tort claims against bankrupt entities. It is well-settled that state law cannot be applied in derogation of federal law. *See, e.g.*, *Perez v. Campbell*, 402 U.S. 637, 649-51 (1971) (remanding matter for determination whether state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress") (citing *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (affirming decree restraining state

officials from enforcing state law found to intrude on federal scheme)). Because Petitioner's arguments are equally applicable to *Amici*, *Amici* adopt those arguments.

CONCLUSION

For the reasons stated above, as well as those set forth in the Petition, certiorari should be granted.

Dated: August 21, 2006

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